19/81 84750-10

Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research & Planning Division

Friday (Noon)

Mar. 6, 1981

This week financial markets were nervous, and trading was generally slow. Part of the nervousness could be ascribed to the upward pressure on the funds rate early in the week--and that in turn probably reflected in part the distortions created by some operating problems experienced then with the Fed wire, as well as the market's realization, as of last Friday night, that banks as a whole had average reserve deficiencies of $278 million and discount window borrowings of $1.7 billion in the previous statement week--both indicative of substantially greater pressure on reserve positions. On the other hand, the 0.8% increase in the Producer Price Index reported today was less than most had expected, and that led to some paring back of rates.

Underlying the market's nervousness is a growing conviction that the Federal Reserve intends to be extremely cautious in allowing interest rates to decline. Indeed, the bottom of the Fed's acceptable range for the funds rate is probably 14%-15%--and, unlike past months, the constraint is apparently being taken seriously now.

There are several reasons why the Fed might take this stance. First, as various members of the Board have emphasized repeatedly, the Fed probably erred in the second quarter of 1980 by allowing rates to drop too quickly and does not intend to make the same mistake this time around. Supporting this view is the fact that recent forecasts of economic activity have generally underestimated the degree of strength in the economy. If the Fed's forecasts have been roughly in line with those of private forecasters—and the FOMC minutes suggest that is the case--the FOMC may logically want to err on the side of caution in easing, especially since few convincing signs of a slowdown have yet emerged (witness the small drop in the February unemployment rate).

Moreover, while it is true that M-1B is slightly below the bottom of its "adjusted" 6%-8 1/2% target range, the last several weeks have produced an upward thrust of the aggregate--not a trend, of course, but not the sort of thing that would spur the Fed to ease its policy stance. In addition, it is very possible that for technical forecasting reasons the Fed is looking for continued strength in the weekly numbers for the duration of the quarter.

Thus it boils down to a good case for waiting a while to see some more results, and the next FOMC meeting would be a good occasion for the Fed to assess its policy. Consequently, we do not expect the weekly average funds rate to move below 15%-16% until after that.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

	3/6/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	18.50%	19.00%	17.75%
Effective since	3/3/81		
Discount Rate at Federal Reserve Bank	13.00	13.00	13.00
Federal Funds	16.00	15.50	17.00
Repurchase Agreements	15.75	15.13	15.75
U.S. Treasury Issues			
Bills			
3 months	15.02	14.77	16.71
6 months	14.99	14.93	16.85
1 year	14.41	14.45	16.22
Coupons			
2 years	13.92	13.86	15.40
4 years	13.75	13.65	14.25
7 years	13.34	13.52	13.45
10 years	13.23	13.34	13.10
Long Bond	12.76	12.86	12.60
Negotiable Certificates of Deposit-Secondary Market			
1 month	15.50	15.15	17.25
3 months	15.70	15.40	17.75
6 months	15.75	15.60	18.00
1 year	15.50	15.50	17.00
Banker's Acceptances			
1 month	15.45	15.00	17.25
3 months	15.65	15.35	17.80
6 months	15.60	15.75	18.50
Eurodollar Deposits			
1 month	16.38	16.00	18.25
2 months	16.50	16.38	18.75
3 months	16.63	16.63	18.88
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	15.25	15.00	17.00
1 month	15.00	14.50	17.13
3 months	14.25	14.00	15.00
Bank Holding Companies			
1 month	15.63	14.88	16.75
Dealer Placed:			
3 months	15.25	15.20	17.25
New AA Corporate Utility Bond	15.75	15.15	14.50
Tax Exempt			
6 month Project Notes	7.20	7.10	7.50
1 year AAA Bond	7.30	7.00	NA
5 year AAA Bond	8.00	7.65	NA
20 year AAA Bond	9.85	9.35	8.50

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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